

Volatility Pairs Trading – Our Teaser Strategy (Intro)

We are going to look at a brief strategy to help you visualise the ideas we will be covering.

Pairs Trading: VIX vs VSTOXX

In pairs trading, you want a pair that cointegrates. This usually means that we need to choose 2 assets that are very similar.

Our choices for our strategy are the VIX¹ Index future and VSTOXX² future³.

- VIX Index future (VX) is an asset that measures the volatility of a group of US stocks.
- VSTOXX future (FVS) is an asset that measures the volatility of a group of European stocks.

Strategy: If VX and FVS diverge (i.e. move away) from each other, we make a bet that they come back to each other.

Don't worry about the details for now. We will cover what these assets are, and what futures are in detail later.

Analysis Steps

With almost all strategies, we try to visualise it using charts or some other way if possible.

To analyse our pairs trading idea, we will use tradingview.com to chart these 2 assets and check if there is opportunity.

If there is any glimpse of potential, we will move on to a statistical analysis.

Note:

The analysis in the next few lectures are meant to be brief and not rigorous. We just want to get an overview of this strategy's potential using basic tools in the fastest time possible.

We will do a thorough backtest in later chapters.

¹ Extra info: <https://www.investopedia.com/terms/v/vix.asp>

² Extra info: <https://www.daytrading.com/vstox>

³ Extra info: <https://algotrading101.com/wiki/futures-finance/>